

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the matter of:

Section 272(f)(1) Sunset of the BOC
Separate Affiliate and Related
Requirements

WC Docket No. 02-112

2000 Biennial Regulatory Review
Separate Affiliate Requirements of Section
64.1903 of the Commission's Rules

CC Docket No. 00-175

**COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION
AND OF THE PEOPLE OF THE STATE OF CALIFORNIA
ON FURTHER NOTICE OF PROPOSED RULEMAKING**

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The California Public Utilities Commission and the People of the State of California (CPUC or California) hereby file these comments in response to the Further Notice of Proposed Rulemaking (FNPRM) issued by the Federal Communications Commission (the Commission) regarding regulatory classification of Bell Operating Companies' (BOCs) and incumbent independent local exchange carriers' (ILECs) if and when those carriers provide in-region, interstate and international interexchange telecommunications services outside of a separate affiliate.¹ In the FNPRM, the

¹ See Further Notice of Proposed Rulemaking, FCC 03-111, WC Docket No. 02-112, CC Docket No. 00-175, adopted May 15, 2003 and released May 19, 2003.

Commission seeks comment on the need for dominant carrier regulation of BOCs' in-region long distance service after sunset of the separate affiliate requirements of section 272 of the Telecommunications Act of 1996 (1996 Act); classification of ILECs as non-dominant or dominant in the provision of in-region long distance services if the Commission modifies or eliminates the ILEC separate affiliate requirement; and alternative regulatory approaches in lieu of dominant carrier regulation to address potential anticompetitive behavior. The following comments address these three major areas of inquiry but do not propose to answer all of the questions set forth in the FNPRM.

I. SUMMARY

In their respective local exchange markets, BOCs and ILECs continue to possess market power and are thus dominant. Because the BOCs/ILECs' entry into the long distance market does not diminish their dominance in the local market, the FCC should recognize the likelihood that the BOCs and ILECs may leverage their local market power into market power in the long distance market to the competitive disadvantage of existing and future entrants. The CPUC thus recommends that the Commission remain vigilant and, while not imposing what the Commission defines as "dominant carrier regulation" on the BOCs and ILECs at this time, closely monitor their respective market shares in the long distance market. The Commission should keep the door open to imposing such dominant carrier regulation in the future if and when a BOC's or ILEC's market share meets a certain market share threshold.

The CPUC also recommends that the existing protections against anticompetitive behavior set forth in section 272 of the 1996 Act (1) remain applicable to BOCs after the section 272 separate affiliate requirements sunset and (2) apply to ILECs as well, regardless of the BOCs/ILECs' regulatory classification and the corresponding status of dominant carrier regulation. While the Commission appears to characterize the section 272 safeguards (other than the separate affiliate requirement of sections 272(a) and (b)) as separate and distinct "alternatives" to "dominant carrier regulation," they are, in fact, part of an overall regulatory framework necessary to prevent potential and actual anticompetitive behavior by the BOCs and other ILECS that continue to possess substantial market power in their respective local markets.

II. BACKGROUND

In the 1980s, the Commission established a regulatory framework to distinguish between two types of carriers: those with market power (dominant carriers) and those without market power (non-dominant carriers). Dominant carrier regulations were and are generally designed to prevent a carrier from raising prices by restricting its output rather than by raising its rivals' costs.² Under dominant carrier regulation, carriers are subject to price cap regulation; must file tariffs on 14, 45, or 120 days' notice with supporting cost data; and must obtain specific prior Commission approval to construct a

² *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, FCC 97-142, ¶ 85, 12 FCC Rcd 15756, 15804 (1997) (LEC Classification Order).

new line, to acquire, lease, or operate any line, or to discontinue, reduce, or impair service, pursuant to 47 U.S.C. section 214 and 47 C.F.R. Part 63.³

Pursuant to the 1996 Act, BOCs authorized under section 271 to provide long distance service are subject to statutory separate affiliate requirements designed to address potential discrimination and cost misallocation. Following passage of the 1996 Act, the Commission revisited BOC affiliates' and ILECs' provision of long distance services and decided that dominant carrier regulation should be imposed on a carrier only if it could unilaterally raise and sustain prices above competitive levels and thereby exercise market power by restricting its output or by its control of an essential input (e.g. access to bottleneck facilities). Based on the separation and other requirements of sections 271 and 272 of the Act, the Commission concluded that BOC interLATA affiliates lacked such ability and should be classified as non-dominant in the long distance market. The Commission also classified ILECs as non-dominant and required them to provide long distance services through separate affiliates, but allowed ILECS providing long distance services exclusively through resale to do so through a separate corporate division subject to certain safeguards. The 1996 Act's separate affiliate requirements sunset on a state-by-state basis three years after a BOC gains permission to provide long distance.

³ *Id.* ¶ 12, at 15766.

III. DISCUSSION

A. A Carrier's Organizational Structure Is Not Significant As Long As The CPUC Is Able To Monitor Cost Allocations Through Appropriate Accounting Rules

As an initial matter, the CPUC does not oppose eliminating the BOC/ILEC separate affiliate requirements. Regardless of a carrier's organizational structure for its local exchange and long distance operations, the CPUC needs to have reliable financial information on each of the carrier's respective lines-of-business. Acquisition of such information requires accurate cost tracking policies, procedures, and systems in place at the carriers to ensure proper allocation between all lines-of-business, regulated local exchange and long distance, and non-regulated aspects of a BOC/ILEC's business. Thus, a carrier's organizational structure is not significant as long as the CPUC is able to monitor cost allocations through appropriate accounting rules and reporting requirements.

B. The Commission Should Closely Monitor The BOCs/ILECs' Increasing Long Distance Market Share For Potential Market Power Abuses

1. The BOCs/ILECs Remain Dominant In The Local Market in California As Well As Nationwide

Based on the data reported to the Commission and the CPUC, the BOCs/ILECs possess market power and thus remain dominant in their respective local markets. As the Commission reported in its June 2003 competition report, the CLEC local market share is growing slowly but remains small. As of the end of 2002, CLECs served just 13.2% of

the total nationwide end-user switched access lines.⁴ Of that 13.2%, 26% -- or 3.4% of the total switched access lines -- represents CLEC-owned facilities.⁵ In other words, as of year-end 2002, 96.6% of all nationwide switched access lines were served by an ILEC either directly, through the ILEC's facilities, or indirectly by a CLEC using an ILEC's facilities, whether via resale or unbundled network elements (UNEs). With regard to California, the Commission reported that CLECs served 11% of the end user switched access lines, and 33% of those lines -- 3.6% of the total switched access lines -- were actually CLEC-owned.⁶

The CPUC's most recent analysis of the status of competition in California supports the Commission's data. In its February 2003 report on competition to the California state legislature, the Telecommunications Division of the CPUC found that, as of June 2002 access line data, ILECs had a 95% share of the local residential market in California, versus the CLECs' 5% market share.⁷ Two ILECs, SBC and Verizon, were the "top two companies in California's local residential and business markets."⁸ Also as of June 2002, SBC "dominate[d] California's residential and business telecommunications markets," serving at least 93% of the local residential market and

⁴ Wireline Competition Bureau, Industry Analysis & Technology Division, Federal Communications Commission, Local Telephone Competition: Status as of December 31, 2002 (June 2003), Table 1.

⁵ *Id.*, Table 3.

⁶ *Id.*, Tables 6 and 10.

⁷ Telecommunications Division, CPUC, The Status of Telecommunications Competition in California: Second Report for the Year 2002 (Feb. 28, 2003), § 3.1.1, at 13.

⁸ *Id.* § 3.1.2, at 14.

81% of the local business market.² Similarly, using revenues as another measure of market share, the Telecommunications Division determined that, from January 2001 through June 2002, “ILECs earned nearly all of the local market revenues,” with 98% of local residential revenues and 93% of local business revenues.¹⁰

The above data demonstrates that competition in the local markets still has a long way to go. The BOCs/ILECs have not lost much of their market share since implementation of the 1996 Act, and progress has been slow. As the CPUC concluded in its review of SBC’s section 271 authorization in late 2002: “Local telephone competition . . . has yet to find its way into the residences of the majority of California’s ratepayers.”¹¹

2. The BOCs/ILECs Have the Ability And Opportunity To Leverage Their Market Power in the Local Market Into The Long Distance Market

Regardless of how the Commission defines the long distance market, the BOCs/ILECs’ control over access services – the so-called “bottleneck services” on which the CLECs heavily rely to compete in the local market – provides them with the power and opportunity to impede competition in the long distance market. Although SBC states that there is only a “theoretical possibility” that BOCs/ILECs might use the local exchange network to harm long distance competitors,¹² that possibility may indeed

² *Id.* § 3.1.1, at 13.

¹⁰ *Id.* § 3.1.3 at 15.

¹¹ *Decision Granting Pacific Bell Telephone Company’s Renewed Motion for an Order That It Has Substantially Satisfied the Requirements of the 14-Point Checklist In § 271 of the Telecommunications Act of 1996 and Denying That It Has Satisfied § 709.2 of the Public Utilities Code*, Cal. P.U.C. Decision 02-09-050, 2002 Cal. PUC LEXIS 619 (Sept. 19, 2002) (CPUC Section 271 Decision), *mimeo* at 263 and 303 (Finding of Fact 336).

¹² *See* Comments of SBC Communications, Inc., June 30, 2003, at v.

develop into actuality. The 1996 Act exists because Congress and the Commission were and remain concerned about BOC/ILECs' incentives to engage in price discrimination, cost shifting, and predatory pricing. Indeed, in the CPUC's review of SBC's section 271 authorization, as in this proceeding, competitors raised numerous concerns regarding BOC/ILEC anticompetitive behavior.¹³ In light of these continuing concerns, the Commission should continue to be vigilant in monitoring the BOCs/ILECs emergence in the long distance market.

**3. Although The BOCs/ILECs Do Not Currently
Wield Market Power in the Long Distance Market,
Their Market Share Is Rapidly Increasing**

The need for the Commission's vigilance is even greater in light of the BOCs/ILECs' increasing market shares in the long distance market. While not to the point of wielding market power, and although total nationwide BOC market share for residential users may be relatively small – 15.8% of households in 2002¹⁴ -- the BOCs/ILECs are making rapid gains in certain states in short periods of time following their individual section 271 approvals.

Gone is the “zero” market share the Commission noted in the LEC Classification Order.¹⁵ For example, SBC received its section 271 approval to provide long distance service in California in December 2002. In a period of approximately four months, SBC

¹³ CPUC Section 271 Decision, *mimeo* at 245-47 and 301-02 (Finding of Fact 320).

¹⁴ Wireline Competition Bureau, Industry Analysis & Technology Division, Federal Communications Commission, Statistics of the Long Distance Telecommunications Industry (May 2003), Table 15, at 29.

¹⁵ LEC Classification Order, ¶ 96, 12 FCC Rcd at 15810-11.

has made significant inroads into the California long distance market. According to its own April report to investors, SBC has “reached a retail long distance line penetration of 13 percent in the consumer segment and 10 percent overall.”¹⁶ That same April investor briefing also reported that SBC:

- “delivered its strongest long-distance performance to date” in the first quarter of 2003, “driven by growth in California”¹⁷;
- increased its interLATA long distance lines in service more than 40% over the past year;¹⁸
- added 1.5 million long-distance lines nationwide in the first quarter of 2003;¹⁹ and
- reached 50% retail voice line penetration for consumer lines in the six other states besides California in which SBC provides long distance (Texas, Missouri, Oklahoma, Arkansas, and Connecticut).²⁰

The BOCs/ILECs’ ability to garner a significant market share in a relatively short period of time raises several concerns. As other commenters have pointed out, the BOCs/ILECs have gained this market share while providing long distance service through resale and theoretically no more efficiently than their rivals. The BOCs/ILECs’ ability to gain ground so quickly, then, would appear to come from their continued dominance in the local market, *e.g.* through their ability to joint market local and long

¹⁶ SBC Investor Briefing, No. 235 (April 24, 2003), at 7.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 3.

²⁰ *Id.* at 7. Many commenters cite statistics from states other than California, and we will not repeat them here. *See, e.g.*, Comments of Ad Hoc Telecommunications Users Committee, June 30, 2003, at 15-16 (NY, TX); Comments of AT&T, *(footnote continued to the next page)*

distance to their millions of local service customers for little, if any, incremental cost and through their role as Preferred Interexchange Carrier (PIC) administrator.

The CPUC has expressed concern in both of these areas. In the review of SBC's section 271 authorization, the CPUC expressed disagreement with the Commission's view "that permitting the incumbent to joint market its long distance affiliate's services to incoming callers is a harmless and nondiscriminating advantage" and stated that "we are mindful that unrestricted use of customer contacts could be unfair and jeopardize customer service" without appropriate protections.²¹ The CPUC also found that a "substantial possibility of harm to the intrastate long distance telephone market exists from [SBC's] continuing role as the PIC administrator."²² After noting these examples of potential anticompetitive behavior, the CPUC stated that "we foresee the harm to the public interest if actual competition [in the local telephone market] in California maintains its current anemic pace, and [SBC] gains intrastate long distance dominance to match its local influence."²³ The Commission needs to remain aware of these concerns and monitor the BOCs/ILECs' increasing long distance market share and how they are obtaining that market share.

C. The Commission Should Preserve The Option Of Imposing Dominant Carrier Regulation If And When A

(footnote continued from previous page)

June 30, 2003, at 62-63 (NY, MA, TX).

²¹ See CPUC Section 271 Decision, *mimeo* at 249.

²² *Id.*, *mimeo* at 303 (Finding of Fact 330); see also *id.* at 261-62 and 303 (Finding of Fact 331) ("[SBC] failed to offer any assurance that it would perform its LPIC role with any safeguards of neutrality or sensitivity to competitor concerns.")

²³ *Id.*, *mimeo* at 263 and 304 (Finding of Fact 338).

BOC's Or ILEC's Market Share Meets A Certain Market Share Threshold

The current level of regulation – collectively set forth in the 1996 Act and in what the Commission defines as “dominant carrier regulation” -- provides the lowest common denominator of regulation necessary to prevent anticompetitive behavior by companies exerting market power in the long distance market. Dominant carrier regulation promotes competition and deters anticompetitive behavior, whether long distance service is provided via a separate affiliate or integrated within the local exchange company.

For example, the requirement of advance filing of tariffs with cost support data provides a number of important, competition-promoting functions. Tariffs allow the Commission to review, accept, and reject the charges the long distance carrier proposes to charge. They provide some level of evidence regarding the basis for prices charged for services, the underlying costs of the services, and the terms and conditions under which services are offered; as such, they protect against price squeezes by revealing whether rates are supported by costs or whether the carrier is pricing its service below cost in an effort to undermine its competitors. Tariffs also make it more likely that regulators are able to catch potential cost misallocations, including non-access costs not covered by the access imputation requirements of section 272(e)(3) of the 1996 Act (discussed below in section D). Finally, the advance tariff filing process may deter market abuse at the outset by the very fact that the carriers cannot keep the supporting data to themselves. All of these benefits outweigh the possible burden of restricting BOCs/ILECs' ability to react to changes in the market.

It is premature, however, to decide the regulatory classification of BOCs/ILECs at this time. The BOCs/ILECs are not dominant in the long distance market, and it may be counter-productive and harmful to competition to require them at this time to abide by dominant carrier regulation in the absence of market power. Thus, the CPUC recommends that the Commission set a threshold market share that would trigger imposition of dominant carrier regulation in the future. To allow for monitoring of market share, the Commission should require the BOCs/ILECs to formally file quarterly market share and penetration data with the Commission and the appropriate state commissions. The CPUC further recommends that, one year after the issuance of a ruling on this FNPRM, the Commission require an independent audit of BOC/ILEC reported market share data to obtain an opinion as to the reasonableness and accuracy of the reported data, with the carriers bearing the costs of these audits.²⁴ The Commission could then examine each carrier's long distance market share in a formal proceeding, preserving the option to impose dominant carrier regulation if any carrier reaches the specified threshold market share.

²⁴ The CPUC recommends that the Commission solicit comments on (1) what the threshold market share should be that triggers dominant carrier regulation as well as (2) what point in time the Commission should conduct the independent audit prior to a BOC/ILEC reaching that threshold market share. In addition, the Commission should determine the scope of the independent audit with input from the states.

D. While Not Providing Complete Protection Against Anticompetitive Behavior, Section 272(e) of the 1996 Act Provides Safeguards That Should Apply In Their Entirety Post-Sunset

The Commission should conclude that the 1996 Act's section 272(e) safeguards, while not perfect, apply to both ILECs and to BOCs post-sunset, regardless of their regulatory classification and the corresponding applicability of dominant carrier regulation.²⁵ Such application of subsections 272(e)(1) through (4) would provide a minimum level of anticompetitive protection by requiring that competitors be allowed nondiscriminatory interconnection on the same terms and conditions as the BOCs/ILECs, whether the BOCs/ILECs provide long distance through a separate affiliate or an integrated company. To remove the section 272(e) requirements – especially within months of SBC's section 271 authorization in California – would create a regulatory vacuum in the California long distance market which is undergoing rapid market share shifts rarely seen in normally functioning markets.

In the FNPRM, the Commission appears to characterize the section 272 safeguards (other than the separate affiliate requirement of sections 272(a) and (b)) as separate and distinct “alternatives” to what the Commission defines as dominant carrier regulation. Yet the protections of the 1996 Act do not hinge on the BOCs/ILECs’

²⁵ Section 272(e)(1) requires a BOC to fulfill requests from competitors for telephone exchange service and exchange access within a period no longer than that in which the BOC provides such service or access to itself or an affiliate. Section 272(e)(2) forbids a BOC from providing facilities/services/information regarding its provision of exchange access to its affiliate unless such facilities/services/information is made available to other long distance providers on the same terms and conditions. Section 272(e)(3) requires a BOC to impute to itself or charge its affiliate the same or a greater access charge than it charges competitors. Section 272(e)(4) allows a BOC to provide its interLATA or intraLATA services/facilities to its long distance affiliate if such services/facilities are made available at the same rates and on the same terms and conditions to all carriers, and as long as the costs are properly allocated.

regulatory classification and whether or not the Commission imposes dominant carrier regulation. Rather, they are collectively part of an overall regulatory framework to prevent potential and actual anticompetitive behavior by BOCs and other ILECs that continue to possess substantial market power in their respective local markets, and should apply post-sunset. Not only does section 272(f)(1) explicitly state that the section 272(e) protections continue post-sunset, but it would be counter-intuitive to allow BOCs/ILECs to sidestep nondiscrimination and imputation requirements just because they will be providing long distance service from a different organizational structure; the purpose of the 1996 Act is to foster full and fair competition, and the form of the company should be irrelevant.

As currently written, however, section 272(e) does not go far enough; its requirements are insufficient to ensure a fully functional competitive market. First, as the Texas Public Utilities Commission stated, a mechanism is necessary to verify compliance with the nondiscriminatory access and imputation requirements of sections 272(e)(1) and (3).²⁶ A process should exist to track the time it takes to fulfill orders from the BOCs/ILECs' long distance operations versus orders from competitors. The CPUC has noted compliance problems in the past in this area. For example, with regard to section 272(e)(1), the CPUC determined that SBC (then Pacific Bell) failed to meet the parity requirements for the pre-ordering qualification (K1023) process for xDSL loops during

²⁶ See Comments of the Public Utilities Commission of Texas, June 30, 2003, at 3.

several months in 2001; the average response time to pre-order queries for CLECs was approximately twice the average response time for same period to pre-order queries for ASI, the then-Pacific Bell DSL affiliate.²⁷ A reporting requirement would assist the CPUC in identifying such noncompliance more readily in the future.

Second, section 272(e)(2) should be similarly strengthened to require BOCs/ILECs to report what facilities, services, or information they provide to their long distance operations and under what terms and conditions. This information will allow the Commission and the state commissions to monitor compliance more effectively.

Finally, with regard to sections 272(e)(3) and (4), the Commission should apply Part 64 so that an established procedure exists to allocate costs between the BOCs/ILECs' different lines-of-business. BOCs already have Part 64 cost allocation systems in place, and modifying them to accommodate the allocation of costs to the long distance operations should not be any more burdensome than if they were to offer any other non-regulated service that currently falls under Part 64.

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²⁷ CPUC Section 271 Decision, *mimeo* at 132-33 and 288 (Findings of Fact 183 and 184).

IV. CONCLUSION

Regardless of whether the BOCs/ILECs provide long distance service via a separate affiliate or an integrated company, the BOCs/ILECs retain market power in the local market and have the ability and opportunity to leverage that market power into the long distance market. The Commission must remain watchful for potential market power abuses in the future and preserve the option of imposing dominant carrier regulation if the BOCs/ILECs' respective market shares in the long distance market reach a certain threshold. Because of their importance in deterring anticompetitive behavior, the Commission also should apply section 272(e) of the 1996 Act post-sunset to both BOCs and ILECs and consider strengthening its provisions to allow the Commission and state commissions to monitor compliance more effectively.

Respectfully submitted,

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